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Remedies for Oppression in Close Corporations in Indiana

NOTES

REMEDIES FOR OPPRESSION IN CLOSE CORPORATIONS IN INDIANA

I. Introduction

In 1916 C owned 480 shares of stock in a corporation with a capital stock of $25,000, divided into shares of $25 each. A and B together owned 519 shares and the daughter of one of them owned one share. In 1916 at the annual stockholders' meeting, the A and B faction elected themselves directors and appointed themselves officers of the company. Until 1924, the A and B faction retained full control of the corporation while voting and paying themselves large salaries in excess of the reasonable value of their services. Personal business was mixed with corporate business. A and B appropriated merchandise that was intended as compensation to the corporation for services rendered and also sold a linotype machine to the corporation for $1,600, greatly in excess of its actual value. No accurate accounts of the receipts and disbursements of the corporation were kept, and C was denied access to the books and accounts of the company until he sued for his common law right. A and B took credit for sums of money paid out for the corporation's benefit which were not so paid. C offered to sell his stock to A and B for its fair value, but A and B refused to pay more than par value and demanded twice the par value for their own stock. The corporation was a solvent going concern and dividends had been earned.[1]

The foregoing is an example of oppression in a close corporation. This note will deal with the remedies available to the minority stockholder in Indiana in such cases of oppression.

The close corporation, although difficult to define, has rather distinct characteristics. Generally, but not necessarily, it is a small enterprise with respect to capital assets and business volume. It has few stockholders, most of whom participate in the management of the corporation as either directors or officers with the result that there is substantial identity of stock ownership and management. The stock is not listed or sold on the public market, and sale to outsiders is often prohibited.[2] Usually each stockholder has invested heavily in the enterprise,

1. Enterprise Printing and Publishing Co. v. Craig, 195 Ind. 302, 144 N.E. 542 (1924).
2. Tingle, The Stockholder's Remedy of Corporate Dissolution 65 (1959).

fully expecting to draw a salary while participating on a full-time basis in the management of the business.[3] The close corporation resembles a partnership in that the stockholders usually pick their own business associates and expect to participate in the management of the business. The participants often think of themselves as partners and refer to each other as such. In some cases the enterprise began as a partnership with the switch to corporate form based upon the desire of the partners for limited liability, continuity of existence, and tax advantages in certain cases.[4] Logically, the stockholder's predominant interests under such a corporate arrangement would be the same as in a partnership, namely economic benefit and participation rights in the business. Partnership law recognizes and protects these interests,[5] but under corporation law the management of the corporation is conferred on the board of directors,[6] and a shareholder's influence on the management of the corporation is merely a derivative of his right to vote in the election of directors. This may leave little control to the minority stockholder.

Accompanying the corporate form are the concepts of the separate corporate entity and perpetual existence with the result that an enterprise often attains a shield of sanctity unsupportable by reason.[7] Also, the courts apply the principles of the "business judgment" rule and the "majority control" rule in such a way that the majority can take advantage of the literal letter of the law and avoid its duty of good faith and discretion in the management of the business.[8] The minority stock-

3. O'NEAL AND DERWIN, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES 6 (1961); TINGLE, *op. cit. supra* note 2, at 66.

4. O'NEAL AND DERWIN, *op. cit. supra* note 3, at 23; TINGLE, *op. cit. supra* note 2, at 66.

5. See, *e.g.*, UNIFORM PARTNERSHIP ACT §§ 18(e) (h), 32.

6. IND. ANN. STAT. § 25-208 (Burns Supp. 1965).

7. See generally Israels, *The Sacred Cow of Corporate Existence*, 19 U. CHI. L. REV. 778 (1952); TINGLE, *op. cit. supra* note 2, at 6.

8. See generally O'NEAL AND DERWIN, *op. cit. supra* note 3, at 42-44, 192-195. The Indiana courts have not discussed or utilized the "business judgment" rule to date, but under the rule the courts of other jurisdictions recognize the directors' broad discretion in determining business policy and managing the corporation and are very reluctant to interfere. The Indiana courts tend to emphasize the "majority control" rule in allowing the directors free reign in the management of the corporation. Of course the "majority control" rule is nothing more than the basic corporate principle that the majority of stockholders in a corporation have the right to control the management of its affairs through the election of dummy directors or themselves who in turn manage the corporation as a majority, limited to a certain extent in most states for the purpose of fundamental corporate acts, such as charter amendments, mergers, or consolidation. The rationale for these rules as listed by O'Neal and Derwin are (1) the majority of stockholders have selected the directors to manage the business, and the courts are not justified in substituting their judgment for that of managers selected by the owners of the business, (2) the directors' decisions are often complex and technical business decisions which the court has no qualifications to pass on, (3) there should be a heavy burden on the complaining stockholder in order to discourage "strike

holder seeks his remedy against this background.

There is a wide range of squeeze-out or oppression tactics available to controlling stockholders and their lawyers. An awareness of these tactics is necessary to appreciate the effectiveness of the remedies, keeping in mind that the more subtle the tactic, the more difficult it is to obtain adequate relief. Some of the more common methods are withholding dividends, eliminating minority stockholders from company employment, and siphoning off earnings by high compensation to controlling stockholders.[9] Since the majority stockholders control the corporation, fundamental corporate changes can be used to accomplish squeeze-outs. Thus, charter and by-law amendment and merger and consolidation have effectuated squeeze-outs.[10] Also, the sale of the corporate business, franchises and assets, as well as dissolution, have been utilized. Reduction of capital, use of bankruptcy proceedings, and dilution of minority stockholder interests through issuance of new stock are additional methods. Certain contractual arrangements constitute some of the more subtle squeeze-out techniques.[11] Examples of these include siphoning off earnings by favorable leases, loans without interest, and exorbitant compensation to outside enterprises controlled by the majority stockholders. The majority has also split off part of the corporation's business and transferred it to other majority-controlled businesses. Finally, usurpation of corporate opportunities by majority stockholders in their individual capacities; maneuvers relating to corporate meetings, including failure to hold meetings and circumventing or eliminating cumulative voting; manipulation of stock transfers; denying access to corporate properties, books, and records; and even squeeze tactics under Subchapter S of the Internal Revenue Code are representative samples of the techniques utilized by majority stockholders and their lawyers. Recognition of the breadth of these techniques and the innumerable combinations in which they appear helps one appreciate the minority stockholder's problem.[12]

suits" and, (4) the majority rule principle has carried over with it the sanctity that it enjoys in the Anglo-American political sphere. These rationale are weak as regards the case of the close corporation. The precise points where they break down are discussed throughout the body of the text but see text preceding note 93 particularly.

9. See generally O'NEAL AND DERWIN, *op. cit. supra* note 3, at 41-61.

10. *Id.* at 61-99.

11. *Id.* at 99-140.

12. Most of the problems of squeeze-out can be precluded in the initial stages of incorporation or by amendment at a later date by drafting protective provisions in the corporate articles or by-laws or by entering outside agreements with the majority. There is recent indication that the courts in states without special close corporation statutes are beginning to recognize the inherent differences between the public and close corporation and are giving legal effect to certain protective devices which under the general law of corporations might not otherwise be valid. See, *e.g.*, Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1965). This note, however, will not deal with such aspects of corporate

The combination of the corporate structure, lawyers' inventiveness, and legal literalness can be catastrophic for a minority stockholder. His expected economic benefits may not materialize and his original investment may become valueless. Since close corporations seldom pay dividends, the minority stockholder who is removed from his salaried position receives no return on his capital investment. If dividends were being paid, the majority may withhold or accumulate profits on the pretext that in their "business judgment" the accumulation is necessary for the protection or long-term planning of the corporation, and the courts are generally reluctant to interfere because of the "business judgment" rule. Nor can the minority stockholder withdraw his investment or sell his interest, because there is little market for minority shares in a close corporation, let alone a strife-torn close corporation. Less painful but possibly as damaging in the long run, the minority stockholder can be deprived of information on the affairs of the business and kept from the corporate books unless he enforces his rights by litigation.

The reverse aspect of the oppression problem in close corporations should be noted also. This is the problem of the unreasonable and uncooperative minority shareholder. As one source outlined the problem, "An unreasonable and obstreperous shareholder may voice frequent objections and criticisms of management, harass employees, demand information on corporate affairs at unreasonable times, bring shareholder's derivative actions, and in general give company managers a 'rough time.' "[13] There are also situations in which an officer or employee may become incompetent through alcoholism, health or old age reasons.[14] Another frequent situation is that of the heir of a minority stockholder who gets unrealistic ideas about what he is entitled to as a successor in interest.[15] In certain of these situations, justice requires that the majority be permitted some fair means to control or remove persons detrimental to the commercial interests of the business. And, in fact, there is statutory provision in some jurisdictions providing for the removal of directors by order of a court of equity for reasonable and just cause.[16] Although this problem is not within the main thrust of this

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planning, but will be limited to those corporate situations in which preventative measures either failed or were never taken. The latter is often the case.

13. See generally O'NEAL AND DERWIN, *op. cit. supra* note 3, at 24.

14. *Id.* at 15-16.

15. *Id.* at 14-15.

16. See, *e.g.*, PA. STAT. ANN. tit. 15, § 2852-406 (1958). In Markovitz v. Markovitz, 336 Pa. 145, 8 A.2d 46 (1939) decided under clause c of the Pennsylvania statute, a director was removed for harassing and embarassing his fellow officers and employees while in the transaction of company business, and the decree fixed a two-year period during which the director was barred from re-election. Of course, prior to enactment

discussion, it must be kept in mind when considering the merits and practical effects of the remedies available to minority stockholders.

II. Derivative Suits

Faced with the dismal prospects discussed above the minority stockholder might in certain circumstances bring a derivative suit. Such a suit is brought in equity by a stockholder, usually of minority interest, as representative of a corporate cause of action, the corporation being the real party in interest.[17] As noted earlier, the minority stockholder under present corporate law and judicial interpretation is subject to mismanagement and unfair manipulation by the majority.[18] The derivative suit which utilizes the wide range of remedies available in equity is an important device in calling the majority to account.[19] Several theoretical explanations of the nature of the derivative suit have been offered.[20] It is typically said that the stockholders have a right in equity to compel the assertion of a corporate right of action against the directors or other wrongdoers when the corporation refuses to sue and, thus, to assert its rights of action when the corporation has been put in default by the wrongful refusal of the directors or management to take suitable measures for its protection. Thus, the derivative suit might appear to afford an excellent means to relieve or remove squeeze-out pressure. Nevertheless, the suit has been infrequently used in Indiana in oppression and squeeze-out situations and then with only limited success.[21]

The "exceptional situations"[22] in which a derivative suit may be

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of this statute, the election and removal of directors was within the exclusive control of an intra-corporate body, generally being the stockholders.

17. Hawes v. City of Oakland, 104 U.S. 450 (1881). That the suit is equitable in nature is uncontroverted. "If an injury is committed or threatened against the corporation which will constitute a violation of the equitable rights of stockholders, and for any reason a dissenting stockholder cannot obtain redress or relief through the corporation, a court of equity will grant appropriate relief in a suit brought by him in his own behalf, or in behalf of himself and other stockholders who may come in and be made parties, according to the circumstances." 13 Fletcher, Private Corporations § 5945 (perm. ed. rev. repl. 1961). The Indiana cases of Wayne Pike Co. v. Hammons, 129 Ind. 368, 27 N.E. 487 (1891) and Marcovich v. O'Brien, 63 Ind. App. 101, 114 N.E. 100 (1916) support the preceding statement. This means that plaintiffs are not entitled, as a matter of right, to a trial by jury on issues of fact or damages. Neff v. Barber, 165 Wisc. 503, 162 N.W. 667 (1917); Steinway v. Griffith Consol. Theaters, Inc., 273 P.2d 872 (Okla. 1954).

18. See text following note 12 *supra.*

19. See generally 13 Fletcher, *op. cit. supra* note 17, at §§ 6029-6042.

20. McLaughlin, *The Mystery of the Representative Suit*, 26 Geo. L.J. 878, 897 (1937-38).

21. The suit has been used by minority stockholders in situations of close corporation oppression approximately a dozen times.

22. The "exceptional situations" were originally set out in Hawes v. City of Oakland, 104 U.S. 450, 460 (1881) and have been adopted by the Indiana courts in Marcovich v. O'Brien, 63 Ind. App. 101, 111, 114 N.E. 100, 103 (1916) and Tevis v. Hammersmith, 31 Ind. App. 281, 282, 66 N.E. 79, 80 (1903).

successfully brought include a contemplated *ultra vires* action or actions by the directors; an action by the directors in their own interest; a fraudulent transaction completed or contemplated by acting managers in connection with some other party, or among themselves, causing injury to the corporation or stockholder; and a course of action where a majority of the stockholders are illegally or oppressively pursuing a course of action in the name of the corporation which is in violation of the rights of the stockholders.[23] However, the courts utilize the "business judgment" rule and "majority control" rule in judging the situations enumerated, so that only the more flagrant abuses are remedied.

Some situations in which relief has been secured in derivative suits include a case involving embezzlement where the corporation president was selling assets, greatly advanced in price, below the market value at a profit to himself;[24] an unauthorized contract by which the directors and officers transferred part of the railroad without consent of the stockholders;[25] a case where the corporation president was indebted to the corporation for the use of its property for his individual purposes and profit without accounting therefor;[26] a case where the majority had continuously absorbed big profits by way of director and officer salaries while never declaring dividends and failing to keep corporate assets in repair thereby rendering the property non-productive;[27] a case where the corporation was being sued for indebtedness and was remaining idle, making no attempt to meet its obligations;[28] a case where the corporation was insolvent due to the misappropriations of its management;[29] and a case where the majority stockholder transferred corporate property into his wife's name and misappropriated funds.[30] Such cases qualify under the "exceptional situations" criteria despite the "business judgment" and "majority control" rules because in all cases the wrongful conduct was prohibited either by a statutory or a charter-by-law provision and did not involve close questions of director discretion.

The case of *Green v. Felton*[31] shows how indiscriminate application of the "majority control" rule limits the scope of protection afforded by the derivative suit and how the courts rely heavily on the corporation's

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23. *Ibid.*
24. Tevis v. Hammersmith, 31 Ind. App. 281, 66 N.E. 79 (1903).
25. Bd. of Comm. of Tippecanoe Co. v. Lafayette, Muncie, and Bloomington R.R., 50 Ind. 85 (1875).
26. Rogers v. Lafayette Agricultural Works, 52 Ind. 296 (1875).
27. Wayne Pike Co. v. Hammons, 129 Ind. 368, 27 N.E. 487 (1891).
28. Sheridan Brick Works v. Marion Trust Co., 157 Ind. 292, 61 N.E. 666 (1901).
29. Supreme Sitting of the Order of the Iron Hall v. Baker, 134 Ind. 293, 33 N.E. 1128 (1893).
30. Tri-City Electric Service Co. v. Jarvis, 206 Ind. 5, 185 N.E. 136 (1933).
31. 42 Ind. App. 675, 84 N.E. 166 (1908).

financial status in determining whether to render relief to oppressed stockholders. Because the majority stockholder's actions in the case were within the strict letter of corporate law and the corporation was financially successful, the appellate court denied the minority stockholder's request for a temporary receivership and an accounting even though the discretion employed by the majority was highly questionable.[32] Although technically correct in its findings, except perhaps in regard to the reasonableness of the salaries,[33] the case illustrates how the majority stockholders can obtain control and approach oppressive management while remaining within the law. It also indicates that certain cases which might properly fall within the protection afforded by the derivative suit are excluded due to the cautiousness of the courts.[34]

The derivative suit may only be used in a limited situation. First, the plaintiff must show that the cause of action is in favor of the corporation in order to bring the suit.[35] An injury to the plaintiff as a stockholder in an individual capacity does not give rise to a derivative suit.[36] Nor can injury to the corporation by a third party be the basis of an

32. Green v. Felton, 42 Ind. App. 675, 685, 84 N.E. 166, 170 (1908). In this case the majority stockholders voted an amendment to the by-laws allowing the vote of a majority of the board of directors to set salaries of the directors and officers each year. The majority stockholders then voted themselves in as directors and moved their salaries from $75 per year in 1899 to $400 per year in 1904 while allowing a free allowance for gas in their dwelling houses each year. Other managerial actions and inactions were challenged as fraudulent and destructive of the minority stockholders' interests, but the challenges were dismissed as either wrong or matters for the directors' discretionary handling. The majority directors were within the law in changing the by-law and within the by-law in raising their salaries. Their actions in management of the corporation were discretionary, and the court expressly found that there was no fraud, conspiracy, mismanagement, or conversion of the funds of the corporation. The company had profited under the majority directors' management, and the court took the approach that as long as they were successful, no cause of action could arise in the absence of injustice or oppression amounting to fraud. A finding of fact that their services were worth $250 per year was deemed only an inference of the unreasonableness of the salary and not sufficient to sustain the trial court's decree that the directors turn such excess salaries over to the corporation. Furthermore, the court said that it had no visitorial power to determine whether the by-laws of a voluntary association are reasonable and no right to set aside the action of majority stockholders and directors, legally acting under the rules of the state and corporation, unless there was clear evidence of fraud.

33. The court's factual finding that $250 per year was a reasonable salary makes the review court's holding that the defendants' $400 per year salaries were not so unreasonable as to be fraudulent at least questionable.

34. The most recent case substantiating this point is Ziffrin Truck Lines, Inc. v. Ziffrin, 242 Ind. 544, 180 N.E.2d 370 (1962) which is discussed beginning in text accompanying note 121 *infra*.

35. Hawes v. City of Oakland, 104 U.S. 450, 454 (1881); Marcovich v. O'Brien, 63 Ind. App. 101, 112, 114 N.E. 100, 103 (1916); Tevis v. Hammersmith, 31 Ind. App. 281, 283, 66 N.E. 79, 80 (1903).

36. Dorsey Machine Co. v. McCaffrey, 139 Ind. 545, 38 N.E. 208 (1894).

individual suit against the third party.[37] Such action must be brought derivatively in favor of the corporation when the corporation refuses to bring the action itself.

Good faith in instituting the action must also exist. *Carter v. Ford Plate Glass Co.*[38] implies in dictum that besides injury to the corporation, existence of injury to the plaintiff may be a pertinent factor in determining the plaintiff's good faith. In that case the defendant established that the plaintiff could have easily avoided injury but for his own negligent inaction. The plaintiff was impliedly in bad faith in bringing the suit because he was responsible for his own injury.

Third, the person bringing the suit must be a record owner of stock in the corporation.[39] There is question, however, whether the owner of an equitable interest may maintain the suit in Indiana. This would arise where a minority stockholder died and left his stock in trust with his "partner" squeezor as trustee. There are no Indiana cases ruling on this point, but dictum in *Wright v. Floyd*[40] suggests that an equitable interest would be sufficient.[41] A majority of jurisdictions allow the owner of an equitable interest to maintain the suit.[42] Cases have also held that stock purchased on the margin and held by the stockholder entitles him to bring the suit,[43] but there is no right to sue derivatively as administrator on a statutory distribution.[44]

Having established proper interest, the plaintiff must hold stock at

37. Smith v. Parker, 148 Ind. 127, 45 N.E. 770 (1897); Tomlinson v. Bricklayers Union # 1 of Ind., 87 Ind. 308 (1882); Brannan v. Kelley, 83 Ind. App. 250, 148 N.E. 157 (1925); Cutshaw v. Fargo, 8 Ind. App. 691, 34 N.E. 376 (1893).

38. 85 Ind. 180, 186 (1882).

39. Wright v. Floyd, 43 Ind. App. 546, 548, 86 N.E. 971, 972 (1909).

40. *Id.* at 547, 86 N.E. at 972. In this case a publishing corporation was established by the Church of the United Brethren in Christ for whose benefit the printing establishment was operated. The Church of the United Brethren in Christ and its members were the beneficiaries of the printing establishment and as such had an equitable interest therein. The court held that the plaintiff seeking to bring the suit as a minority trustee of the publishing corporation for the benefit of the corporation did not allege a sufficient interest in the controversy. In dictum, however, the court suggested that interest in the controversy either as shareholder, stockholder, member of the board, or *beneficiary* would have been a sufficient fulfillment of the interest requirement, thereby including equitable. (Emphasis added)

41. The case of Miller v. Jackson Township, 178 Ind. 503, 512, 99 N.E. 102, 104 (1912) supports the ultimate conclusion of the reasoning in *Wright v. Floyd*. In the *Miller* case the court, in a suit brought by a taxpayer on behalf of the township against a township trustee and the sureties on his bond, allowed the taxpayer to bring the suit on the strength of his equitable interests. After it took jurisdiction of the case the court stated it was disposed to rendering legal remedies if it felt the need great enough.

42. 13 FLETCHER, *op. cit. supra* note 17, at § 5976.

43. Parsons v. Joseph, 92 Ala. 403, 8 So. 788 (1891); Gamble-Skogmo, Inc. v. Saks, 35 Del. Ch. 503, 122 A.2d 120 (1956).

44. Faiello v. LiCastri, 2 App. Div. 2d 749, 153 N.Y.S.2d 247 (1956).

the time he brings the suit and during the continuation of the suit.[45] However, there is no law in Indiana requiring that ownership be contemporaneous with the injury,[46] a requirement that could work definite hardship in certain instances despite its obvious function to prevent "strike suits." Otherwise a purchaser of stock could not bring a derivative suit if a flagrantly abusive transaction took place just before he secured his interests, even if the abuse was of such a nature as to reduce the value of his subsequently acquired interest. However, since the purchase of stock in close corporations is infrequent and cautiously approached, this problem will not be significant.

An interesting contemporaneous ownership problem which is significant arises when a derivative suit is removed to a federal court on diversity of citizenship. The federal rules require contemporaneous ownership[47] and cases have interpreted the requirement as procedural, so that derivative suit cases lacking contemporaneous ownership may be dismissed even though the law of the state in which the court is sitting did not have the requirement.[48]

Fifth, all intra-corporate remedies must be exhausted before bringing the suit.[49] The initial opportunity to sue for corporate injuries is in the corporation's board of directors.[50] Therefore, the plaintiff in a derivative suit must allege and prove that he has exhausted his remedies within the corporation by making demand upon the directors that they institute the suit and their refusal.[51] If, however, the plaintiff can show that such demand would be unavailing or harmful to his action, the requirement is waived.[52] An example is a situation in which a corporation's charter requires three or more directors but due to the death of one of them and irreconcilable dissensions among the others the company is being managed by a stockholder without right to control its business affairs, the net result being an absence of a management to

45. Wright v. Floyd, 43 Ind. App. 546, 548, 86 N.E. 971, 972 (1909).

46. HENN, CORPORATIONS § 356 (1961) incorrectly asserts that Tevis v. Hammersmith, 31 Ind. App. 281, 66 N.E. 79 (1903) states a contemporaneous ownership requirement, but this is not brought out in this case or in any other Indiana case.

47. FED. R. CIV. P. 23(b).

48. Perrott v. U.S. Banking Corp., 53 F. Supp. 953 (D. Del. 1944); Piccard v. Sperry Corp., 36 F. Supp. 1006 (S.D. N.Y. 1941); Lissauer v. Bertles, 37 F. Supp. 881 (S.D. N.Y. 1940). The question was posed in Gallup v. Caldwell, 120 F.2d 90 (3d Cir. 1941).

49. Marcovich v. O'Brien, 63 Ind. App. 101, 112, 114 N.E. 100, 103 (1916); Wright v. Floyd, 43 Ind. App. 546, 547, 86 N.E. 971, 972 (1909); Tevis v. Hammersmith, 31 Ind. App. 281, 283, 66 N.E. 79, 80 (1903).

50. IND. ANN. STAT. § 25-208 (Burns Supp. 1965).

51. Marcovich v. O'Brien, 63 Ind. App. 101, 112, 114 N.E. 100, 103 (1916).

52. *Ibid.*

which application for relief can be made.[53] When a demand can be made, it must be made at a meeting of the directors and not to the directors individually.[54] The fact that not all the complaining stockholders make demands is not destructive of the action.[55]

Besides demand upon the directors, Indiana has adopted the requirement[56] set forth in *Hawes v. City of Oakland*[57] that if time permits or has permitted, the plaintiff must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body in the matter of which he complains. If this is not done he must show that it could not be done or it is unreasonable to require it. The general American view in this regard is that shareholder demand is waived when the wrongdoers are in the majority.[58] Of course, the majority in a close corporation would not ratify any resolution by the minority under such circumstances. Even where oppressed stockholders might by united action elect new directors who would act for the benefit of the corporation, demand upon the wrongdoing stockholders for stockholder action has been waived when the delay involved would preclude preventing the injury to the corporation.[59] In the case of a public corporation where there was a possibility of obtaining stockholder ratification, a federal court applying Indiana law has held that demand upon the stockholders would be futile and therefore unnecessary because the directors, not the stockholders, manage the corporation, including bringing actions for it, and stockholder resolutions cannot compel the management to bring the suit. Even if the directors complied, the bringing of the suit would in most cases lie in the hands of those hostile to the corporation.[60]

In keeping with the equitable doctrine of "clean hands," Indiana cases also hold that the plaintiff must have had no share in the wrongful acts.[61] Nor can the stockholders bringing the suit have ratified the wrongful conduct of the management.[62] The standard for ratification is discussed below.[63]

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53. Sheridan Brick Works v. Marion Trust Co., 157 Ind. 292, 61 N.E. 666 (1901).
54. Tevis v. Hammersmith, 31 Ind. App. 281, 289, 66 N.E. 79, 82 (1903).
55. Perlman v. Feldmann, 129 F. Supp. 162, 194 (D. Conn. 1952), *rev'd on other grounds* 219 F.2d 173 (2d Cir. 1955), *cert. denied* 349 U.S. 952 (1955).
56. Brannan v. Kelley, 83 Ind. App. 250, 257, 148 N.E. 137, 159 (1925).
57. 104 U.S. 450, 461 (1881).
58. Note, *Demand On Directors And Shareholders As A Prerequisite To A Derivative Suit*, 73 HARV. L. REV. 746 (1960).
59. Tevis v. Hammersmith, 31 Ind. App. 281, 287-288, 66 N.E. 79, 82 (1903).
60. Perlman v. Feldmann, 129 F. Supp. 162 (D. Conn. 1952), *rev'd on other grounds* 219 F.2d 173 (2d Cir. 1955), *cert. denied* 349 U.S. 952 (1955).
61. Marcovich v. O'Brien, 63 Ind. App. 101, 111, 114 N.E. 100, 103 (1916); Tevis v. Hammersmith, 31 Ind. App. 281, 283, 66 N.E. 79, 80 (1903).
62. *Ibid.*
63. See text accompanying notes 70-74 *infra*.

If the plaintiff has a valid derivative action, he must then contend with the procedural requirements of the suit.[64] The corporation as the real party of interest without which the derivative suit cannot be brought, must be made a party defendant so that a decree may appropriately give the corporation the fruit of any recovery and serve as *res adjudicata.*[65] This of course assumes that the consent of the corporation to join as party plaintiff will be unobtainable, since it is in the control of the defendant directors.

It has been held that all stockholders of the corporation need not be named as party plaintiff or party defendant in bringing a derivative suit; but in an ancillary action for appointment of a receiver all stockholders of record have to be a party to the action.[66] The latter holding, however, was without precedent and has not been followed since.

The time limitations on bringing the derivative suit go to the nature of the suit which sounds in equity. But often the corporate cause of action is legal in nature posing the question of whether laches or the various statutes of limitation should apply.[67] The Civil Code of 1852 resolved the question by establishing one form of action. Statutes of limitation apply to suits formerly cognizable at law or in equity alike because there is but one form of action for enforcement of private rights.[68] However, laches may be invoked to estop plaintiffs who do not bring a timely suit.[69] Often the asserted basis for estoppel in corporation litigation is that the plaintiffs have ratified the actions of the directors upon which they base their complaints.[70] Thus, in *Carter v. Ford Plate Glass Co.*[71] the plaintiffs were estopped even though they were bringing the action only seven months after the transaction in question. This then raises the collateral issue of what the standard for ratification is in Indiana. Although expressly established as being "full knowledge" in a federal court applying Indiana law,[72] a more recent state decision indicates

64. This is not an attempt to deal with all the procedural aspects involved in bringing a suit. The discussion will be limited to only those procedural aspects which are troublesome or peculiar to the suit.

65. IND. ANN. STAT. § 2-220 (Burns 1946); Carter v. Ford Plate Glass Co., 85 Ind. 180, 182-183 (1882).

66. Tri-City Electric Service Co. v. Jarvis, 206 Ind. 5, 14, 185 N.E. 136, 139 (1933).

67. See generally Note, *Statutes of Limitations and Shareholders' Derivative Actions*, 56 COL. L. REV. 106 (1956).

68. IND. ANN. STAT. § 2-101 (Burns 1946); *cf.* Terry v. Davenport, 185 Ind. 561, 112 N.E. 998 (1916).

69. Carter v. The Ford Plate Glass Co., 85 Ind. 180 (1882).

70. *Id.* at 186. Perlman v. Feldmann, 129 F. Supp. 162, 194 (D. Conn. 1952), *rev'd on other grounds* 219 F.2d 173 (2d Cir. 1955), *cert. denied* 349 U.S. 952 (1955).

71. 85 Ind. 180 (1882).

72. Perlman v. Feldmann, 129 F. Supp. 162, 194 (D. Conn. 1952), *rev'd on other grounds* 219 F.2d 173 (2d Cir. 1955), *cert. denied* 349 U.S. 952 (1955).

that something less than "full knowledge" could constitute ratification.[73] The court said, "some knowledge of a contract relationship and an opportunity for full knowledge thereof, coupled with the acceptance of the benefits therefrom over a long period of time" would constitute ratification.[74]

The theory of action which determines which statute of limitations will be applied is determined by the combination of acts, lawful and unlawful, allegedly committed.[75] Derivative suits involving oppression typically sound in tort which has a two-year statute in Indiana.[76] However, no matter what theory the complaint sounds in, it must allege a breach of fiduciary duty running from those in control to the minority stockholders.[77] Current judicial trend is that the controlling stockholders, especially those in close corporations, owe a fiduciary duty to the minority and the breach of this trust can be the basis of a suit in equity.[78] Since there is no statutory time limit on breach of fiduciary duty, it may be that derivative suits fall under the catch-all fifteen-year statute.[79]

Because of the size and complexity of derivative suits in large public corporations the cost of such litigation can be astronomical.[80] To offset this, the courts generally allow liberal counsel and accountant fees to provide the plaintiff with the necessary incentive for the volunteer method of representation in derivative suits.[81] The fees are taken out of funds recovered or savings made for the corporation, but as such still constitute a substantial drain on corporate funds.[82] In addition, under Indiana law the corporation has the power to indemnify the directors and officers for expenses actually and reasonably incurred in defense actions whether civil or criminal to which they are made parties because of their corporate positions, except where adjudged negligent or in misconduct of performance of duty.[83]

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73. Miller v. Ortman, 235 Ind. 641, 682, 136 N.E.2d 17, 40 (1956).
74. *Ibid.*
75. *Id.* at 664, 136 N.E.2d at 40.
76. IND. ANN. STAT. § 2-601 (Burns 1946).
77. TINGLE, *op. cit. supra* note 2, at 30-34; O'NEAL AND DERWIN, *op. cit. supra* note 3, at 137-139.
78. Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955), *cert. denied* 349 U.S. 952 (1955); O'NEAL AND DERWIN, *op. cit. supra* note 3, at 137-139.
79. IND. ANN. STAT. § 2-603 (Burns 1946).
80. Perlman v. Feldmann, 160 F. Supp. 310 (D. Conn. 1958) awarded $450,000 attorneys' fees and $38,000 in disbursements for a $1,150,000 settlement.
81. Kalven and Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684, 716 (1940-41).
82. Auer v. Wm. Meyer Co., 322 Ill. App. 244, 54 N.E.2d 394 (1944); Bingham v. Ditzler, 320 Ill. App. 88, 49 N.E.2d 812 (1943).
83. IND. ANN. STAT. § 25-202 (10) (Burns 1960). This provision of the Indiana Act was adopted from the 1957 version of the MODEL BUSINESS CORPORATION ACT. Besides granting general power to the corporation to indemnify directors, the clause

Although public policy does not encourage the institution of derivative suits for close corporations as in the case of public corporations, the minority stockholder's financial interest may be sufficient motive for him to institute the derivative suit. The costs of such litigation, although likely to be less, will be proportionately burdensome and possibly as devastating. Nonetheless, the minority is often willing to take the risks if it will mean permanent relief.

A significant disadvantage of the derivative suit from the plaintiff's point of view is that the relief obtained goes to the corporation.[84] This presents the problem of reimbursing the corporation controlled by the same wrongdoing defendants. Admittedly, the minority stockholder would recover his proportionate share indirectly through his interest in the corporation. But, in reality, the defendant majority stockholders are merely accounting to themselves.[85] There are exceptional cases, however, where direct pro rata recovery has been allowed despite the fact that such a recovery is inconsistent with the theory of the suit. In *Perlman v. Feldmann*[86] such a recovery was allowed because the normal corporate recovery would have resulted in a windfall to new interests in the corporation, thereby giving them part of their purchase price back. Another jurisdiction has allowed pro rata recovery where the corporation was no longer a going concern.[87]

The sufficiency of the derivative suit for the purposes of the oppressed minority depends on the nature of the relief afforded. In cases of flagrant abuse, the courts have isolated certain wrongful actions and have rendered relief. An unauthorized contract has been cancelled;[88] misappropriated funds have been ordered to be accounted for;[89] accounting

also provides that any other indemnifications may be provided by the articles, by-laws, resolutions, or other authorization. This means that the majority in control can adopt exculpatory provisions in the articles etc. and thereby guarantee their own indemnification if negligent or in misconduct as long as such provision was adopted prior to the conduct in question. Only in extreme cases would the courts refuse to give effect to a provision for indemnification as in the willful disregard of a duty or violation of a statute such as the Securities Act of 1933 where personal liability is required to make the statute effectual. MODEL BUS. CORP. ACT ANN. § 4 para. 4.02. Thus, no matter which party wins the derivative suit the corporation will bear the expense of the litigation.

84. 13 FLETCHER, *op. cit. supra* note 17, at § 5953; HENN, *op. cit. supra* note 46, at § 375.

85. TINGLE, *op. cit. supra* note 2, at 18.

86. Perlman v. Feldmann, 219 F.2d 173, 178 (2d Cir. 1955), *cert. denied* 349 U.S. 952 (1955).

87. Bailey v. Jacobs, 325 Pa. 187, 189 A. 320 (1937).

88. Bd. of Comm. of Tippecanoe Co. v. Lafayette, Muncie, and Bloomington R.R., 50 Ind. 85 (1875).

89. Rogers v. Lafayette Agricultural Works, 52 Ind. 296 (1875).

for excessive salaries has been required;[90] constructive trusts have been utilized;[91] and receivers *pendente lite* have been appointed to render physical operations productive.[92] Nonetheless, such remedies only correct immediate abuses. Even those jurisdictions which remove directors for misconduct cannot prevent the majority from filling the board of directors with its own men. Thus, despite the indirect relief afforded by accounting to the corporation, the minority plaintiff's relief is only temporary. Where he has been removed from office and denied a salary and dividends, his real interests of economic benefit and participation in the business are afforded no protection. In such cases the minority stockholder's only true relief is receivership and dissolution wherein he is afforded the right to salvage his damaged interests. However, these remedies discussed below are subject to strict standards which often prevent relief where it may be deserved.

In summary, the broad standard for directors' conduct, the uncertainties of some of the technical aspects of the suit, the temporary nature of the remedies afforded, and the strict standard for the permanent remedy of receivership and dissolution have combined to hinder seriously the effectiveness of the derivative suit as relief for the oppressed minority. Such problems, however, do suggest that proper modifications could make the suit more effective.

It may be that the theoretical justifications for the "business judgment" and "majority control" rules as applied to close corporations need to be re-analyzed judicially. The participants in the close corporations are not usually experienced in the hard reality of "majority rule" and to hold them to it often results in disappointment of expectations of participation in the corporate enterprise. Also, participants in the close corporation often do not conceptualize the "business judgment" rule and have never intended to turn the management of the company completely over to a majority of a board of directors. On the contrary, the participants expect to run the business themselves. Furthermore, to interfere in the management of the close corporation would not usually involve the complex business considerations of public corporation management, so the judicial reluctance to intervene should not be as great. Nor is the danger of "strike suits" as great in close corporations. Thus, the standard of "fair dealing" and "trust" may be more appropriate in the context of the

90. Enterprise Printing and Publishing Co. v. Craig, 195 Ind. 302, 144 N.E. 542 (1924).
91. Tri-City Electric Service Co. v. Jarvis, 206 Ind. 5, 185 N.E. 136 (1933).
92. Wayne Pike Co. v. Hammons, 129 Ind. 368, 27 N.E. 487 (1891).

close corporation than the "winner take all" standard that the courts have applied in the past. Recent legislation in England[93] and legislation and judicial opinion in the United States[94] has taken cognizance of the peculiar problems of the close corporation. Even though this trend is apparent, equitable results in this area can be accomplished without legislative action by re-evaluation of the nature of the close corporation and weighing of the equities involved.

Technical aspects of derivative suits need clarification, for although the case law is straightforward, it is diffuse and therefore uncertain. The most uncertain aspects of the suit, besides the general standards to be employed as discussed earlier,[95] are the interest necessary to bring the suit and the nature of the time limitations for bringing the suit. The stockholder must show ownership of stock in the corporation.[96] But the "type of ownership" and "when" are issues which need definition. Obviously, legal ownership is sufficient, but the question of whether equitable interests will qualify a stockholder should be clarified. It is submitted that the right for equitable interests to sue derivatively should be acknowledged as it is in other jurisdictions,[97] to broaden the protective scope of the suit and to afford relief where it is obviously necessary. Since the suit is equitable in nature, it should admit grievances of equitable interests. This creates a greater risk of "strike suits" in public corporations since additional owners of corporate interests will be extended the right to bring the suit. However, the large public corporation could be protected from "strike suits" by a statutory adoption of a high bond requirement on the party instituting the suit against a large public corporation.

The issue of "when" the legal and equitable interests must be held in order to qualify the holder to bring the suit has only limited significance to the close corporation stockholder as discussed earlier.[98] Therefore, whether Indiana retains its present requirement or adopts the "contemporaneous with the injury" requirement should not depend on close cor-

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93. The [British] Companies Act, 1948, 11 & 12 Geo. 6, c. 38., §§ 164, 165, 210; See generally O'NEAL AND DERWIN, *op. cit. supra* note 3, at 200-209.

94. N.Y. BUS. CORP. LAWS §§ 402(b), 514, 601(c), 613, 615, 616, 617, 620, 701, 703, 706(b), 709, 715, 1002, 1103, 1104 (McKinney's 1965); N.C. GEN. STAT. §§ 55-1 to 55-175 (1957). For a discussion of the statutory changes in North Carolina see generally Latty, *The Close Corporation and the New North Carolina Business Corporation Act*, 34 N.C. L. REV. 432 (1956). For South Carolina statutory changes see Myers, *Close Corporation Under the New South Carolina Corporation Law*, 16 S.C. L. REV. 577 (1964). Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1965) judicially recognizes the peculiar problems of close corporations. See note 12 *supra*.

95. See text accompanying notes 22-34 and preceding note 93 *supra*.

96. Wright v. Floyd, 43 Ind. App. 546, 548, 86 N.E. 971, 972 (1909).

97. 13 FLETCHER, *op. cit. supra* note 17, at § 5976.

98. See text accompanying note 46 *supra*.

poration considerations. Since the "contemporaneous with the injury" requirement is primarily an attempt to prevent a speculator from buying a "strike suit" against a public corporation, the interests of both the public and close corporation could be protected by a statutory adoption of that requirement but restricted to public corporations.

The time limitation for bringing the suit constitutes the second area of uncertainty. At present the nature of the cause of action casts it into one of several different statutory time limitations, all subject to the possibility of shorter periods due to laches. In addition, there is an overriding possibility of a 15-year limitation under the catch-all clause of the statute[99] for breach of fiduciary duty. It should be noted, however, that the statute of limitations causes few problems, because usually the oppressive activities are continuing and operative in the present in the case of close corporation squeeze-out. There might be a danger of the statute of limitations running, however, if the stockholder delayed bringing an action in an attempt to accumulate several oppressive actions before bringing the suit or if he delayed while attempting to acquire enough evidence to initiate a suit. A six-year statute of limitations on derivative suits running from the time of discovery would provide an adequate time limitation and cure the uncertainty of this area. Such period would allow the stockholders ample time to accumulate evidence of oppressive acts and would properly reflect the seriousness in which society holds the concept of trust and breach thereof. The doctrine of laches, however, would properly be retained due to the greater possibility of injury to innocent third parties in many corporate transactions when oppressed stockholders fail to press their claims with reasonable promptness.

III. Receivership and Dissolution as a Remedy for Majority Oppression[100]

Faced with oppression and only able to get temporary relief from the standard equitable remedies of injunction and accounting as discussed earlier,[101] often the minority stockholder's only meaningful remedy is receivership for the "winding up" of the corporation, or at least the threat thereof.[102] If majority stockholders were faced with the

99. Ind. Ann. Stat. § 2-603 (Burns 1946).

100. The discussion and analysis of the remedies of receivership and dissolution are dealt with concurrently since dissolution is actually the last and logical extension of receivership. As a result of their interrelationship, the courts have tended to regard the two in the same light, adopting similar attitudes toward and standards for their application.

101. See text accompanying notes 88-92 and following *supra*.

102. Courts have in the past drawn a distinction between liquidation and dissolution. Liquidation was a selling of all corporate assets, but it did not destroy the legal

drastic threat of receivership and dissolution whenever they oppressed the minority interests, oppression would, no doubt, diminish. If it did not diminish and the corporation was dissolved, the minority stockholder would at least recapture some of his original investment and be free to reinvest elsewhere.

Without doubt, the most striking feature of the remedy of receivership and dissolution is the ultra-cautious and perhaps justifiable attitude adopted by the courts toward its use. This attitude is indicated by the following typical language.

> The authority of a court to appoint a receiver exists by statute. No such right existed under the common law. The appointment of a receiver is an extraordinary equitable remedy. The action affects one of man's most cherished and sacred rights guaranteed by the United States Constitution—the right to be secure in his property. The right is fundamental to every society in which men are free. For these reasons the statute which grants such authority is to be strictly construed.[103]

The rationale for the above comment is self-contained. But, even more significant is the ultimate result of receivership and dissolution. As one author writes:

> Obviously liquidation destroys the increased earning power of combined investments. The stockholders may of course receive as much as or more than their original investments. But the combination is gone. Moreover, forced sale prices are typically below the value of the business as a going concern even if it is sold as a unit. Thus the loss is twofold, arising from the division and reduced value of the whole. (Moreover, there are receivership expenses.) Unless the majority are able to buy the assets they suffer these losses too. . . . Liquidation is a sanction, often the harshest sanction, enforcing the fiduciary duty of honest management.[104]

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entity created by the state. Dissolution was thought of in terms dissolution *de jure* wherein the legal entity was terminated also. The distinction proved helpful to the courts in allowing them to argue that a liquidation, in that it did not terminate the corporate entity, was not as drastic a remedy as dissolution *de jure*. Nonetheless, the ultimate results are the same, and for the purpose of this discussion no distinction between the two shall be drawn. See TINGLE, *op. cit. supra* note 2, at 30-31 for a more extensive discussion. Also, no distinction shall be drawn between the various types of receivers which might be appointed by the courts since the standards for the appointment of receivers *pendente lite* and for winding up are basically the same.

103. State *ex rel.* Makar v. St. Joseph County Circuit Court, 242 Ind. 339, 347, 179 N.E.2d 285, 289-290 (1962).

104. TINGLE, *op. cit. supra* note 2, at 47.

Nonetheless, despite the drastic nature of the remedy, minority stockholders have sought receivership and dissolution preferring the losses incident to division rather than continued majority control,[105] and courts have granted the disfavored remedy when the majority has become so untrustworthy that judicial reluctance to grant liquidation was overcome.[106]

The dictum in one Indiana case implied that the court had inherent power to appoint receivers,[107] and although the common law is vague on the court's power, the authority clearly exists by statute.[108] The statute provides in part that a receiver may be appointed when necessary to salvage and protect endangered property; when a corporation has been dissolved, or is either insolvent or in imminent danger thereof; and when necessary to secure ample justice to the parties. The latter section appears to be a codification of the courts' inherent power to appoint receivers and has been interpreted as such.[109] Most significant, however, is the fact that there is no direct statutory provision in Indiana for receivership and dissolution for "oppression" such as is found in the Illinois statute[110] and the Model Business Corporation Act.[111] Despite this omission, the sweeping discretion afforded the courts by the "ample justice" clause[112] might be used to deal with majority oppression but the clause has not yet been exploited by the Indiana courts.

Obviously, some cases fall clearly within the "insolvency" clause or "danger of injury" clause and have caused the Indiana courts few problems despite their dislike for the remedy.[113] For the purposes of this

105. Little Wonder Light Co. v. Van Slyke, 198 Ind. 269, 153 N.E. 477 (1926); Enterprise Printing and Publishing Co. v. Craig, 195 Ind. 302, 144 N.E. 542 (1924); Becker v. Home Brewing Co., 78 Ind. App. 629, 136 N.E. 847 (1922); Green v. Felton, 42 Ind. App. 675, 84 N.E. 166 (1908).

106. Tri-City Electric Service Co. v. Jarvis, 206 Ind. 5, 185 N.E. 136 (1933) granted the remedy even though it had not been requested.

107. Allied Magnet Wire Corp. v. Tuttle, 199 Ind. 166, 171, 154 N.E. 480, 482 (1926).

108. IND. ANN. STAT. § 3-2601 (Burns 1946).

109. Indianapolis Dairymen's Co-op, Inc. v. Bottema, 226 Ind. 237, 246, 79 N.E.2d 399, 404 (1948).

110. ILL. REV. STAT. ch. 32, § 157.86(a)(3) (1959).

111. ABA-ALI MODEL BUS. CORP. ACT, § 90(a)(2) (1953).

112. IND. ANN. STAT. § 3-2601 (Burns 1946).

113. Jefferson Park Realty Corp. v. Kelley, Glover and Vale, Inc., 105 Ind. App. 313, 12 N.E.2d 977 (1938); Dynamite Drugs, Inc. v. Kerch, 212 Ind. 568, 10 N.E.2d 624 (1938); Specialty Furniture Co. v. Rusche, 212 Ind. 184, 6 N.E.2d 959 (1937); Merriam and Wasson Co., Inc. v. Eagle Pencil Co., 209 Ind. 421, 199 N.E. 243 (1936); South Side Motor Coach Corp. v. McFarland, 207 Ind. 301, 191 N.E. 147 (1934); Sheridan Brick Works v. Marion Trust Co., 157 Ind. 292, 61 N.E 666 (1901); Supreme Sitting of the Order of the Iron Hall v. Baker, 134 Ind. 293, 33 N.E. 1128 (1893); Wayne Pike Co. v. Hammons, 129 Ind. 368, 27 N.E. 487 (1891). These cases are for the most part instances in which the corporation has gone insolvent or is in imminent danger thereof so that a receiver is necessary to protect and maintain those assets which

discussion, however, the focus is upon those cases which push application of the remedy to its most liberal limits.

Enterprise Publishing Co. v. Craig,[114] which is described at the beginning of this note,[115] typifies the pre-1933 approach of Indiana courts. The supreme court reversed the trial court's decree for appointment of a receiver for the purpose of dissolution saying:

> The mere fact that a minority stockholder is excluded from holding office in a corporation, and that the majority stockholders hold all the offices and manage the business is not cause for appointing a receiver, *when the business is being managed successfully in the interest of all the stockholders.*[116] And neither are the facts, as alleged in the complaint, that the owners of a majority of the stock, holding all of the offices, have paid themselves larger salaries than they should, and have blended their private business with the business of the corporation, and failed properly to account for money of the corporation thus commingled with their own. Neither a receivership nor a dissolution is necessary to obtain an accounting on behalf of the corporation.[117]

The standard employed by the court would require that insolvency or danger thereof be established. It also would require proof that receivership was an absolute necessity and a lesser remedy such as accounting was clearly insufficient. The court ignored the continuity of the oppressive acts and the plaintiff's loss of participation in the corporation in which he was a 48 percent owner. Furthermore, a standard based upon insolvency fails to appreciate the nature of the situation from which relief is most often sought. Plaintiffs generally seek relief from oppression of their interests in prosperous corporations. Where the corporation is insolvent parties of interest usually will not bother to assert their interests.

In 1933, however, *Tri-City Electric Co. v. Jarvis*[118] liberalized the receivership standard. In that case the court disregarded the solvency factor and emphasized the continuous course of majority oppression. The supreme court reversed the trial court's decree for appointment of a

remain. The discussion in the text, however, is directed toward cases of oppression and mismanagement in which the corporations are solvent going concerns, because they present finer distinctions in establishing a standard.

114. 195 Ind. 302, 144 N.E. 542 (1924).
115. See text accompanying note 1, *supra.*
116. Emphasis added.
117. Enterprise Printing and Publishing Co. v. Craig, 195 Ind. 302, 311 (1924).
118. Tri-City Electric Service Co. v. Jarvis, 206 Ind. 5, 185 N.E. 136 (1933).

receiver on other grounds than the standard employed, but indicated its position regarding the standard for receivership, calling not only for a receivership but for dissolution on the facts of the case unless the stockholders could adjust their difficulties within a reasonable time.[119]

The plaintiff, a 30 percent stockholder who never had nor desired to participate in corporate management, depended upon her brother, the majority stockholder to manage the company. Stockholders' and directors' meetings were seldom called, and corporate property and rents worth approximately $6,000 were misappropriated over a six-year period by the brother and his wife, the two defendants. Dividends were not declared or paid during the same period while net corporate profit was allegedly $52,000. The corporation was clearly a solvent going concern, but the plaintiff sought receivership as relief from the continued oppression.

The court recognized the drastic nature of the remedy, but felt the continuity of the defendants' oppression was such as to overcome the significance of the corporation's solvency. The defendants had proven themselves untrustworthy, and the court felt dissolution was the only permanent remedy to protect the plaintiff's interest. The holding, in effect, established a more logical and liberal standard than the pre-1933 decisions for relief from close corporation oppression. The financial condition of the corporation was de-emphasized while the continuity of the defendants' oppression and the permanency of the plaintiff's relief were made the controlling factors.

It should be noted, however, that the court narrowed its holding by emphasizing that dissolution was the only solution because the defendant was the only person capable of running the business.[120] This limitation can be expanded, however, by arguing that whether there were one or twenty capable of running the business, as long as the oppressive defendants had voting control the corporate management would as a matter of fact remain in their hands indefinitely whether personally or by dummy directors.

The Indiana courts have retreated from the *Tri-City* standard in some recent cases. The 1962 case of *Ziffrin Truck Lines, Inc. v. Ziffrin*[121] reasserts Indiana's strict standards for the appointment of a receivership despite a continuous string of oppressive acts. In this case the plaintiffs were sons of the defendant and owners of 30 percent of the corporate stock as well as former officers of the corporation. On the

119. *Id.* at 21, 185 N.E. at 141.
120. *Ibid.*
121. Ziffrin Truck Lines, Inc. v. Ziffrin, 242 Ind. 544, 180 N.E.2d 370 (1962).

basis of the appellate briefs[122] (the only source of facts since there was no factual finding), the only acts of oppression which were admitted by the defendant included the improper diversion of corporate funds for non-corporate telephone lines, non-business airplane tickets, work on personal residences, and work for the defendant's other company.[123] Highly questionable activities of the defendant included incurring $50,000 of indebtedness by the corporation in order to pre-pay his own salary, the size of his salary, and the fact that he owed the corporation $27,000 which he was paying back slowly.[124] The defendant admitted that the corporation had operated at a loss for several months, that employee morale was down, and that the company was involved in multiple litigation but laid all of these problems at the feet of the plaintiffs.[125] Most important, however, the plaintiffs were not receiving a return on their 30 percent ownership. The trial court attributed this to a lack of funds caused by paying exorbitant salaries to the defendants for what was really a return on their investment rather than for services rendered.[126] Because the plaintiffs were being fraudulently deprived of dividends on their stock which were being fairly earned, the trial court appointed a temporary receiver pending the litigation.

The trial court recognized that Ziffrin Truck Lines was a solvent going concern, that the plaintiffs had recently been adjudged guilty of conspiracy against Ziffrin Truck Lines for diverting business to a rival truck line of which they were sole owners, and that while managing the business the plaintiffs had participated in the same diversion of corporate funds of which they were now complaining.[127] Nonetheless, the court emphasized the fact that there was no indication that the plaintiffs would ever realize a return on their 30 percent ownership, because it was the practice of the company to distribute returns in the form of salaries.[128] The trial court rejected the defendant's "lack-of-clean-hands" argument, taking the position that the plaintiffs' misconduct in the past did not give the defendant license to oppress the company and minority stockholders in the present and future.[129] As in the *Tri-City* case, the trial court de-emphasized the solvency of the corporation and emphasized protection of the minority stockholders' investment for the future while ordering a

122. Appellees' Answer Brief and Appellants' Reply Brief, Ziffrin Truck Lines, Inc. v. Ziffrin, 242 Ind. 544, 180 N.E.2d 370 (1962) appearing in 10 Indiana Supreme Court Briefs.
123. Appellants' Reply Brief, pp. 25-28.
124. *Id.* at 12-13, 18-23.
125. *Id.* at 28-29, 13-18, 10-12.
126. Record, pp. 67-69.
127. *Id.* at 55-56.
128. *Id.* at 64.
129. *Id.* at 64-69.

receiver for the corporation.[130]

On appeal the order was reversed despite the admitted oppression involved. The supreme court stated that the evidence failed to disclose that an *emergency*[131] existed for the appointment of a receiver or that the plaintiffs did not have an adequate remedy at law.[132] Saying nothing in regard to the continuity of oppression toward the corporation by the defendant or concerning the distinct possibility that the plaintiffs would never realize a return on their 30 percent ownership, the supreme court held that the evidence revealed no *emergency*.[133] The implication of such language seems to be a re-emphasis of the courts' cautious use of the remedy and a return to the more conservative "insolvency" standard used in the *Enterprise Publishing Co.* case and earlier cases.[134] In weighing the evidence the supreme court must have been referring to the financial condition of the company in deciding that there was no emergency. From the viewpoint of the plaintiffs, the defendant's conduct toward the corporation and the prospect of never again receiving a return on their investment did constitute an emergency. The plaintiffs, whether deservedly or not, were being excluded from sharing in the corporate profits, and there was no reason to think the corporation's policy would change. By emphasizing the corporation's financial condition as opposed to the conduct of the defendant and fate of the plaintiffs, the *Ziffrin* case suggests a strict approach to granting receiverships. Such a standard would, in ordinary circumstances, ignore the special problems of the close corporation. However, for the *Ziffrin* case perhaps it produced the just result.

The *Ziffrin* case can be distinguished on its facts from typical oppression situations. The equitable appeal of the plaintiffs' complaint was diminished by their own conduct. Although the facts do not show how the plaintiffs acquired their shares, they may have been received as a gift from their father. In addition, the corporation's financial problems derived in a large part from the plaintiffs' legal actions. Thus, although not discussed, it may be that "lack-of-clean-hands" had bearing upon the supreme court's adoption of the "insolvency" standard. Perhaps its adoption was the easiest way the court could rule for the defendant without being embarrassed by the defendant's misconduct and the plaintiffs' misfortune. If this analysis is correct, absent unclean

130. *Id.* at 70.
131. Emphasis added.
132. Ziffrin Truck Lines, Inc. v. Ziffrin, 242 Ind. 544, 546, 180 N.E.2d 370, 372 (1962).
133. Emphasis added.
134. See text accompanying notes 113-117 *supra*.

hands by the plaintiffs, it is submitted that the standard of the *Tri-City* case might still be a viable approach in cases of continuous oppression in close corporations.

Indiana courts have sufficient statutory authority under the "ample justice" clause[135] to combat oppression through the use of receivership and dissolution. Perhaps this power would be further clarified and exploited if legislation similar to Illinois'[136] and the Model Business Corporation Act[137] were enacted.[138] The Illinois statute provides:

> Courts of equity shall have full power to liquidate the assets and business of a corporation: (a) In an action by a stockholder when it is made to appear: (3) That the acts of the directors or those in control of the corporation are illegal, *oppressive*[139] or fraudulent.

In *Gidwitz v. Lanzit Corrugated Box Co.*,[140] the only case decided under the Illinois oppression provision, in which the conduct complained of was held "oppressive," dissolution was granted despite the fact that the defendant had done nothing illegal. As president of the corporation the defendant, a 50 percent owner, had organized another corporation with its funds without consulting the plaintiffs, who were also 50 percent owners; he had borrowed money for the corporation from his own loan company thereby realizing a profit; and he had hired a "managing officer" at a large salary without board authority as required by the by-laws. The court concluded that:

> The improper acts of Joseph, as president of Lanzit, the *continuing course of conduct*[141] followed by the defendants through their president, the lack of majority control, and the denial to plaintiffs of other corporate rights and privileges, exhibit oppression in this particular situation.[142]

Most significantly the Illinois court added:

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135. IND. ANN. STAT. § 3-2601 (Burns 1946).

136. ILL. REV. STAT. ch. 32, § 157.86(a) (3) (1959).

137. ABA-ALI MODEL BUS. CORP. ACT, § 90(a) (2) (1953).

138. See generally Stern, *Deadlock and Dissolution: Problems in the Closely Held Corporation in Illinois*, 56 NW. U. L. REV. 525 (1961), and *Oppression as a Statutory Ground for Corporate Dissolution*, 1965 DUKE L. REV. 128. Eleven other states have adopted comparable oppression provisions since Illinois did in 1933.

139. Emphasis added.

140. 20 Ill. 2d 208, 170 N.E.2d 131 (1960). Two other recent Illinois cases which considered the meaning of the term "oppressive" but did not find oppression are Central Standard Life Ins. Co. v. Davis, 10 Ill. 2d 566, 141 N.E.2d 45 (1957) and Polikoff v. Dole and Clark Bldg. Corp., 37 Ill. App. 2d 29, 184 N.E.2d 792 (1962).

141. Emphasis added.

142. Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 221, 170 N.E.2d 131, 138 (1960).

> It is not necessary that fraud, illegality or *even loss*[143] be shown to exhibit oppression of plaintiffs and their interests in the corporation.[144]

The Illinois standard for oppression as interpreted in the *Gidwitz* case has been characterized as a cumulative and continuing course of misconduct often involving the exclusion of one faction from the affairs of the business, despite the absence of corporate loss or insolvency and any specifically illegal acts.[145] As such, the standard is more liberal than the *Ziffrin* standard in that it does not regard the financial state of the corporation as controlling and perhaps more liberal than the *Tri-City* standard in that it places more emphasis on the plaintiff's participation rights than on his economic interests. The latter extension is tempered, however, by the fact that in *Gidwitz* there was a deadlock situation which was dormant.

IV. Receivership and Dissolution as a Remedy in Deadlock Situations[146]

As indicated by the *Gidwitz* case,[147] deadlock in the management of the corporation can and often does accompany oppression. This usually occurs when ownership of the controlling stock is split evenly. Deadlock may be characterized as "incomplete," "complete" or "shareholder deadlock," "director deadlock."[148] For example, when there is an odd-numbered directory with two factions or persons each owning 50 percent of the stock, the faction which controls the odd director will in effect have exclusive control of the corporation. Since in Indiana the directory holds over until successors are elected, the corporation would continue to operate, and deadlock would only be "incomplete" despite the failure of the competing factions to elect a new directory. When the directory is even-numbered and the directors and stockholders divide equally on cor-

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143. Emphasis added.

144. Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 220, 170 N.E.2d 131, 138 (1960).

145. Stern, *supra* note 138, at 533-34; *Oppression as a Statutory Ground for Corporate Dissolution*, *supra* note 138, at 136-137. Also, dictum in Central Standard Life Ins. Co. v. Davis, 10 Ill. 2d 566, 573, 141 N.E.2d 45, 50 (1957) to the effect, "The word 'oppressive' does not carry an essential inference of imminent disaster; it can, we think contemplate a continuing course of conduct" reinforces the trend away from an "inevitable ruin" standard. See also the dissenting opinion in Polikoff v. Dole & Clark Bldg. Corp., 37 Ill. App. 2d 29, 39, 184 N.E.2d 792, 796 (1962) which suggests that several misdeeds involving the sole corporate asset plus a disproportionate loss to the minority could constitute "oppression."

146. A great deal of the material in this section is taken from the definitive work on corporate dissolution by Tingle, *op. cit. supra* note 2.

147. 20 Ill. 2d 208, 170 N.E.2d 131 (1960).

148. Tingle, *op. cit. supra* note 2, at 74-76.

porate decisions, management by the directory fails, and deadlock is "complete." At any rate, when deadlock produces oppression of non-controlling interests, remedies for the situation are needed, and this discussion will attempt to analyze the extent of relief available in Indiana.

Despite the absence of a dissolution clause for oppression,[149] Indiana does have a statute empowering courts to dissolve involuntarily a corporation when "the shareholders or directors are deadlocked in the management of the corporate affairs and the corporation is suffering, or is about to suffer, irreparable injury by reason thereof."[150] There have been no Indiana cases establishing what constitutes "shareholder deadlock." However, the Illinois[151] and Model Corporation Acts,[152] in addition to a ground for dissolution based on "director" and "shareholder deadlock" accompanied by "irreparable injury" similar to the Indiana ground, provide for dissolution when "the shareholders are deadlocked in voting power, and have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the election of their successors." Indiana has no express description of "shareholder deadlock" such as this but logically the term is intended to encompass failure to elect directors. The problem is that since there has been no judicial interpretation of the term one cannot predict how many failures to elect directors will constitute "shareholder deadlock." Even if a judicial decision set the number which would constitute "shareholder deadlock," it would still be subject to a showing of "irreparable injury" to the corporation, unlike the Model and Illinois Acts which have dropped that requirement for "shareholder deadlock" of this type. Even if shareholders fail to elect directors at two consecutive annual meetings, holdover directors may continue to run the corporation successfully. It is also doubtful whether deadlock brought about by by-law or charter provisions which increase voting and quorum requirements on certain corporate decisions is the type of deadlock intended to be covered by the Indiana statute.

Because both "director" and "shareholder deadlock" under the Indiana statute require a showing of "irreparable injury," it is clear that the more conservative the standard for finding "irreparable injury" is, the more limited the scope of the dissolution remedy must be. No Indiana cases interpret the requirement but the Illinois case decided under an "irreparable injury" requirement denied dissolution on the basis of the evi-

149. See text accompanying notes 135-145 *supra*.
150. IND. ANN. STAT. § 25-242(6) (Burns 1960).
151. ILL. REV. STAT. ch. 32, § 157.86(a)(1((2) (1959).
152. ABA-ALI MODEL BUS. CORP. ACT, § 90(a)(1)(3) (1953).

dence.[153] One writer has characterized "irreparable injury" as interpreted as "requiring a great deal of proof to show the corporation, because of the deadlock, was on the edge of collapse."[154] Commentators point out the few cases where something less than imminent financial disaster constituted "irreparable harm," but it is conceded that generally "irreparable injury" has a "financial loss to the corporation" type standard and affords minimal relief for oppression unless the deadlock destroys the corporate business.[155] As the discussion of receivership brought out, a standard based on insolvency or financial loss to the corporation ignores the reality of the situation.[156] It does not meet the issue that relief from oppression will generally be sought when the corporation is in fact prosperous. Only Illinois and nine other states whose deadlock provisions are patterned after the Model Act have removed the "irreparable injury" requirement, marking what one author suggests is a "legislative movement away from the common law standard of commercial failure or loss."[157] But this legislative move is limited to "shareholder deadlock."

Thus, the cryptic nature of the Indiana deadlock statute, the lack of judicial interpretation of the statute, and a probable conservative standard for the "irreparable injury" requirement imposed on both "director" and "shareholder deadlock" combined with the strict standards applied to receivership result in only bleak possibilities for the non-controlling party to get a discontinuance of oppression or dissolution in order to salvage his investment. For these reasons a *Tri-City* standard and an oppression and deadlock statute like Illinois' are crucial for the protection of oppressed minority interests.

V. Alternatives

Since the courts have been reluctant to alter their standards for receivership and dissolution despite the great amount of literature on the close corporation squeeze-out problem, perhaps a new approach would be more successful. Several unique remedies have been developed in other jurisdictions which, if utilized, could minimize the problems encountered to date.

Of the three remedies to be discussed, the least helpful is a statutory remedy provided in California.[158] The statute provides that where deadlock is "complete," i.e., "directors deadlock," and it threatens injury to

153. Lush'us Brand Distributors, Inc. v. Fort Dearborn Lithograph Co., 330 Ill. App. 216, 70 N.E.2d 737 (1946).
154. Stern, *supra* note 138, at 529.
155. Stern, *supra* note 138, at 530; Tingle, *op. cit. supra* note 2, at 173-174.
156. See text following note 117 *supra*.
157. Tingle, *op. cit. supra* note 2, at 130-131.
158. Cal. Corp. Code §§ 819, 4655 (Deering 1953).

the corporate business a "provisional director" may be appointed at the suit of one-half of the directors or the holders of one-third of the outstanding shares. The "provisional director" is supposed to be an "impartial person" who continues as a director "until the deadlock in the board of directors is broken or until he is removed by order of the court or by vote or written consent of the holders of a majority of voting shares." The remedy would avoid the commercial stigma of receivership and its inconvenience, but since the "provisional director" would be the only "impartial person" on the board, the arrangement would degenerate into a one-man operation with the "provisional director" making the crucial business decisions on his own much as a receiver *pendente lite* would. Furthermore, the remedy is limited to "director deadlock" situations and is considered useful only during dissolution proceedings.[159] Also, the strategic position between two warring factions would expose the "provisional director" to great factional pressures. At best the "provisional director" would only compliment the regular dissolution procedure.

A second alternative is the "monitored control" remedy adopted by a Texas court in the case of *Patton v. Nicholas*.[160] This case involved a typical oppression situation in which two 20 percent stockholders were removed from office and denied dividends. The Texas supreme court reiterated the equity axiom of the drastic nature of dissolution and reversed the trial court's order for receivership and dissolution. In substitution for dissolution the court ordered the trial court to determine a "reasonable dividend" and to require its payment and if necessary to repeat for the following five years. Thus, the trial court was ordered to continue its jurisdiction over the case for at least five years to see that the controlling interests obeyed the court's injunction to act in good faith toward the minority. If they disobeyed, the trial court was ordered to dissolve the enterprise.

The remedy is an interesting compromise. It saves the defendant's right to manage the corporation while at the same time posing such a drastic result for breach of fiduciary duty that his better business sense would curb any further business oppression. The remedy avoids the drastic measure of dissolution but still affords the plaintiff meaningful relief from oppression. Also, the court would not be obligated to use their standards for dissolution, since the remedy is less drastic.

Nonetheless, the remedy has certain disadvantages, the most obvious being the burden placed upon the trial court in figuring the technical

159. TINGLE, *op. cit supra* note 2, at 165.

160. 154 Tex. 385, 279 S.W.2d 848 (1955). Purcell, 34 TEXAS L. REV. 936 (1956); Ziegler, 24 U. CIN. L. REV. 598 (1955).

computations of fair dividends and policing the corporation. Besides this, the threat of dissolution would only inspire fair treatment for five years. After the five years, the entire litigation would presumably have to be repeated in the event of oppression. As one writer rightfully suggests, there comes a point where the "compound of mercy" for the defendant and "paternal solicitude" for the plaintiff coupled with "solicitude for the almost humanized corporate entity" becomes absurd and kid-glove treatment of corporate dissolution should be abandoned.[161]

The most ingenious remedy developed to date is the "special fiscal agent" device developed in a 1956 New Jersey decision which was characterized by the review court as an "equitable *pendente lite* device contrived hopefully to avoid more stringent measures."[162] The case involved majority oppression in the form of self-dealing and sloppy accounting practices. In order to avoid the commercial stigma of receivership, the court created the "special fiscal agent" as a "roving watchdog" of the majority's business practices. Empowered to check all disbursements from two companies controlled by the defendants in the case, the "special fiscal agent" was given access to the corporation's records and was ordered to report all irregularities to the parties to the suit who could in turn apply to the court for relief. Obviously not as drastic as custodial receivership, courts could more readily grant the remedy without regard to the strict standards for receivership. Also, the remedy gives the court an unbiased report of any irregularities while relieving them of any duty of policing the corporation themselves. Furthermore, control of the corporation is not wrested from the hands of the majority, and the minority is guaranteed continuing relief.

In view of the several interests which a court has to balance when deciding an oppression case in which receivership is sought,[163] the "special fiscal agent" device constitutes the best compromise of the three under discussion. The remedy affords the minority fair relief without destroying the corporate enterprise and the majority's continuing interest, therein. Often, however, termination of the business and withdrawal of interests is what the minority desires and what justice requires. But, this characteristic of receivership is sacrificed by the moderation of the "special fiscal agent" remedy. In addition, the "special fiscal agent" remedy tends to be circular in its ultimate effect. The minority initially brings an action against certain oppressive conduct and seeks receivership

161. TINGLE, *op. cit. supra* note 2, at 50.
162. Roach v. Margulies, 42 N.J. Super. 243, 245, 126 A.2d 45, 46 (1956).
163. The four major interests are of course the minority's interest in his investment and participation in the business, the majority's interest in his investment and control of the business, the interest of the state and society in encouraging legal business enterprise to flourish, and the creditors' interests.

and winding up so that he may salvage his interests. The court is cautious and unwilling to order receivership so it establishes the "special fiscal agent." The "special fiscal agent" investigates, discovers, and informs the minority of oppressive conduct of the majority. The minority can then bring an action for relief. Note, that this is where the minority began the quest for relief, i.e., bringing an action against oppression before a cautious court that was unwilling to grant the only permanent relief available. This analysis must be qualified, however. It is obvious that the court in devising the "special fiscal agent" was interested in protecting minority interests and would, therefore, be more willing to grant relief from majority misconduct disclosed by its own agent. Nonetheless, the remedy could become awkward if oppression was continuous because the minority would have to maintain a steady stream of litigation to protect its interests.

Despite weaknesses in the remedies discussed, the fact that courts have utilized them and established a standard for their application means they can serve as a guide, more likely honored than not, for behavior of the businessmen involved and other businessmen in the jurisdiction. For example, in the "monitored control" remedy, once a pattern of legal behavior is established in the five years of control the tendency will be to carry over the legal business pattern even after the surveillance terminates. The same affect would likely result from the "special fiscal agent" arrangement. Thus, even though there are weaknesses inherent in each, such remedies are valuable for the positive impact they have upon the behavior of businessmen and lawyers alike.